New Supervisory Requirements for Leasing Companies in Germany

As part of a trade off allowing German leasing companies to avoid double taxation due to the application of a municipal trade tax in Germany on rents, leases and lease payments (amongst others), German leasing firms will be subject to the oversight of the German Federal Financial Supervisory Authority (BaFin) going forward. In other words, this implies that German leasing companies will be able to benefit from the same taxation regime as banks if they have BaFin approval to operate as so-called financial services companies.

German legislators initially considered subjecting leasing firms to full banking supervision. However, the regulation that has now been adopted requires only the lowest level of regulation envisaged by the German Banking Act (known as the KWG). This avoids lessors having to comply with the full set of requirements for banks, such as minimum capital, solvency and liquidity requirements.

To qualify as a financial services company, existing leasing firms must submit an appropriate notification to BaFin. BaFin will grant approval to these companies without substantial review. New companies will be subject to the usual approval procedure, which entails, amongst other things, the submission of a viable business model, a description of the planned structure and the risk management system of the company and a demonstration that the managing director is both suitable and possesses the necessary qualifications.

A further key condition for obtaining the exemption from the municipal trade tax is that the company conducts “finance lease” operations. A letter from the supervisory authorities dated March 1999 serves as the basis for defining this term, which differs from the definition in IFRS. Under this definition, finance lease agreements are agreements under which the financing features of the contract take precedence over its asset-transfer features and, as a result, the risks of losses related to the leased asset are transferred to the lessee. For instance, this can be assumed to be the case when the lease term extends over a large proportion of the depreciation period of the leased asset. Thus, full payout agreements, sale and leaseback agreements, agreements with put options and lease-purchase agreements are likely to fulfill this definition. Besides the difficulty in clearly defining the term ‘finance lease’ there remains some uncertainty as to how services often provided along with leases will be assessed under this definition in the future. The German legislator is expected to clarify this soon.

The key aspects of the limited supervisory regime include various qualitative requirements regarding the organisation of business operations which largely correspond to the second pillar of Basel II rules. This implies that the implementation of these legal requirements and the design of a leasing company’s risk management system must be geared to the type and scope of the firm’s activities as well as the firm’s company-specific risk profile. Since the leasing industry already has appropriate instruments for controlling and monitoring risk, the main task for German leasing firms will be to make their existing instruments transparent and to document them adequately. Consequently, only some “missing components” will have to be implemented or possibly outsourced. These requirements are combined with certain disclosure and reporting obligations primarily to the BaFin, particularly relating to large exposures to individual customers on the group level.

A brief look at other European countries shows that the leasing business in established markets like Italy and France and relatively young markets like Hungary are subject to comparable supervision. Here too, finance lease operations are monitored by the financial authorities in accordance with the fundamental requirements of Basel II. This involves compliance with capital rules in some areas as well. Germany has succeeded in implementing a relatively moderate version of the supervisory regulations without capital requirements. However, it remains to be seen how the definition of the term ‘finance lease’, which is surrounded by uncertainty in terms of taxation, will affect the leasing industry as a whole in Germany.

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